



8011-01p

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-89679; File No. SR-FINRA-2020-024]

### **Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Delete the FINRA Order Audit Trail System (OATS) Rules**

August 26, 2020.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 14, 2020, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

FINRA is proposing to eliminate the Order Audit Trail System (“OATS”) rules in the FINRA Rule 7400 Series and FINRA Rule 4554 (Alternative Trading Systems — Recording and Reporting Requirements of Order and Execution Information for NMS Stocks) once members are effectively reporting to the consolidated audit trail (“CAT”) and the CAT’s accuracy and reliability meet certain standards, as described below. The Rule 7400 Series and Rule 4554 are collectively referred to herein as the “OATS Rules.”

---

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

(a) Background

FINRA and the national securities exchanges (collectively, the "Participants")<sup>3</sup> filed with the Commission, pursuant to Section 11A of the Exchange Act<sup>4</sup> and Rule 608 of Regulation NMS thereunder,<sup>5</sup> the National Market System Plan Governing the Consolidated Audit Trail (the "CAT NMS Plan" or "Plan").<sup>6</sup> The Participants filed the Plan to comply with Rule 613 of

---

<sup>3</sup> For a complete list of Participants, see Exhibit A to the Limited Liability Company Agreement of Consolidated Audit Trail, LLC, available at [www.catnmsplan.com/sites/default/files/2020-07/LLC-Agreement-of-Consolidated-Audit-Trail-LLC-as-of-7.24.20.pdf](http://www.catnmsplan.com/sites/default/files/2020-07/LLC-Agreement-of-Consolidated-Audit-Trail-LLC-as-of-7.24.20.pdf).

<sup>4</sup> 15 U.S.C. 78k-1.

<sup>5</sup> 17 CFR 242.608.

<sup>6</sup> See Letter from the Participants to Brent J. Fields, Secretary, Commission, dated September 30, 2014; and Letter from Participants to Brent J. Fields, Secretary, Commission, dated February 27, 2015. On December 24, 2015, the Participants

Regulation NMS under the Exchange Act.<sup>7</sup> The Plan was published for comment in the Federal Register on May 17, 2016,<sup>8</sup> and approved by the Commission, as modified, on November 15, 2016.<sup>9</sup> On March 15, 2017, the Commission approved the FINRA Rule 6800 Series to implement provisions of the CAT NMS Plan that are applicable to FINRA members.<sup>10</sup>

The CAT NMS Plan is intended to create, implement and maintain a consolidated audit trail that will capture in a single consolidated data source customer and order event information for orders in NMS Securities and OTC Equity Securities, across all markets, from the time of order inception through routing, cancellation, modification or execution.<sup>11</sup> Among other things, Section C.9. of Appendix C to the Plan, as modified by the Commission, requires each Participant to “file with the SEC the relevant rule change filing to eliminate or modify its duplicative rules within six (6) months of the SEC’s approval of the CAT NMS Plan.”<sup>12</sup> The

---

submitted an amendment to the CAT NMS Plan. See Letter from Participants to Brent J. Fields, Secretary, Commission, dated December 23, 2015.

Unless otherwise specified, capitalized terms used in this rule filing are defined as set forth in the CAT Compliance Rule Series or in the CAT NMS Plan.

<sup>7</sup> 17 CFR 242.613.

<sup>8</sup> See Securities Exchange Act Release No. 77724 (April 27, 2016), 81 FR 30614 (May 17, 2016).

<sup>9</sup> See Securities Exchange Act Release No. 79318 (November 15, 2016), 81 FR 84696 (November 23, 2016) (“Approval Order”).

<sup>10</sup> See Securities Exchange Act Release No. 80255 (March 15, 2017), 82 FR 14563 (March 21, 2017) (Order Approving File No. SR-FINRA-2017-003). See also Securities Exchange Act Release No. 89119 (June 22, 2020), 85 FR 38468 (June 26, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2020-018).

<sup>11</sup> See, e.g., Securities Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722, 45723 (August 1, 2012).

<sup>12</sup> In compliance with this requirement, in May 2017, FINRA filed a proposed rule change to eliminate the OATS Rules and amend FINRA’s electronic blue sheet (“EBS”) rules, Rules 8211 and 8213 (“original proposal”). See Securities Exchange Act Release No. 80783 (May 26, 2017), 82 FR 25423 (June 1, 2017) (Notice of Filing of File No. SR-FINRA-2017-013). FINRA filed an amendment to the original proposal on August 25,

Plan notes that “the elimination of such rules and the retirement of such [sic] systems [will] be effective at such time as CAT Data meets minimum standards of accuracy and reliability.”<sup>13</sup>

Finally, the Plan requires the rule filing to discuss the following:

(i) specific accuracy and reliability standards that will determine when duplicative systems will be retired, including, but not limited to, whether the attainment of a certain Error Rate should determine when a system duplicative of the CAT can be retired;

(ii) whether the availability of certain data from Small Industry Members<sup>14</sup> two years after the Effective Date would facilitate a more expeditious retirement of duplicative systems; and

---

2017. See Securities Exchange Act Release No. 81499 (August 30, 2017), 82 FR 42168 (September 6, 2017). The original proposal was subsequently withdrawn but provided similar views and mechanisms for eliminating the OATS Rules as this proposed rule change does and, as noted above, also proposed to amend the EBS rules. See Securities Exchange Act Release No. 82524 (January 17, 2018), 83 FR 3239 (January 23, 2018) (Notice of Withdrawal of File No. SR-FINRA-2017-013).

FINRA notes that the current filing addresses only the elimination of the OATS Rules. Proposed amendments to the EBS rules would be subject to a separate FINRA rule filing made in conjunction with SEC rulemaking to amend Rule 17a-25 under the Exchange Act. 17 CFR 240.17a-25.

<sup>13</sup> See CAT NMS Plan, Appendix C, Section C.9.

<sup>14</sup> As noted in footnote 6, unless otherwise specified, capitalized terms used in this rule filing are defined as set forth in the CAT Compliance Rule Series or in the CAT NMS Plan. “Small Industry Member” is defined in FINRA Rule 6810(nn) as an Industry Member that qualifies as a small broker-dealer as defined in SEA Rule 0-10(c). On April 20, 2020, the Commission granted exemptive relief from certain provisions of the CAT NMS Plan related to broker-dealers that do not qualify as Small Industry Members solely because such broker-dealers satisfy Rule 0-10(i)(2) under the Exchange Act in that they introduce transactions on a fully disclosed basis to clearing firms that are not small businesses or small organizations (referred to as “Introducing Industry Members”). Specifically, the Commission provided exemptive relief from requiring Introducing Industry Members to comply with the requirements of the CAT NMS Plan that apply to Industry Members other than Small Industry Members (“Large Industry Members”), provided that the Participants require such Introducing Industry Members to comply with the requirements of the CAT NMS Plan that apply to Small Industry Members. See

(iii) whether individual Industry Members can be exempted from reporting to duplicative systems once their CAT reporting meets specified accuracy and reliability standards, including, but not limited to, ways in which establishing cross-system regulatory functionality or integrating data from existing systems and the CAT would facilitate such Individual Industry Member exemptions.<sup>15</sup>

In response to these requirements, the proposed rule change deletes the OATS Rules from the FINRA rulebook.<sup>16</sup> The proposed rule change will be implemented once the CAT achieves the specific accuracy and reliability standards described below and FINRA has determined that its usage of the CAT Data has not revealed material issues that have not been corrected, confirmed that the CAT includes all data necessary to allow FINRA to continue to meet its surveillance obligations and confirmed that the Plan Processor is sufficiently meeting its

---

Securities Exchange Act Release No. 88703 (April 20, 2020), 85 FR 23115 (April 24, 2020) (Order Granting Limited Exemptive Relief Related to Certain Introducing Brokers From the Requirements of the CAT NMS Plan) (the “Introducing Brokers Exemptive Order”).

As used herein, the term “Small Industry Member” includes Introducing Industry Members in accordance with the Introducing Brokers Exemptive Order.

<sup>15</sup> See CAT NMS Plan, Appendix C, Section C.9.

<sup>16</sup> FINRA is considering whether there are additional FINRA rules that can be deleted or amended, as necessary, upon the implementation of CAT, e.g., trade reporting rules requiring the submission of “non-tape” regulatory reports relating to riskless principal and agency transactions (Rules 6282, 6380A, 6380B and 6622), Rule 6431 (Recording of Quotation Information) and Rule 4590 (Synchronization of Member Business Clocks). Such proposed changes would be subject to a separate rule filing with the SEC.

In addition, FINRA notes that there are multiple rules throughout the FINRA rulebook that cross-reference or otherwise incorporate some or all of the OATS Rules. If the Commission approves the proposed rule change, FINRA would file a proposed rule change to delete or amend, as applicable, the references to the OATS Rules before the amendments in the current proposed rule change are implemented.

obligations under the CAT NMS Plan relating to the reporting and linkage of Phase 2a Industry Member Data, which as discussed further below, will replicate what is in OATS today.<sup>17</sup>

(b) Specific Accuracy and Reliability Standards

The first issue the Plan requires the proposed rule change to discuss is “specific accuracy and reliability standards that will determine when duplicative systems will be retired, including, but not limited to, whether the attainment of a certain Error Rate should determine when a system duplicative of the CAT can be retired.”<sup>18</sup> FINRA believes that relevant error rates are the primary, but not the sole, metric by which to determine the CAT’s accuracy and reliability and will serve as the baseline requirement needed before OATS can be retired.

As discussed in Section A.3(b) of Appendix C to the CAT NMS Plan, the Participants established an initial Error Rate, as defined in the Plan, of 5% on initially submitted data (i.e.,

---

<sup>17</sup> FINRA notes that OATS was originally proposed to fulfill one of the undertakings contained in an order issued by the Commission relating to the settlement of an enforcement action against FINRA (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) for failure to adequately enforce its rules. See Securities Exchange Act Release No. 39729 (March 6, 1998), 63 FR 12559 (March 13, 1998) (Order Approving File No SR-NASD-97-56) (“OATS Approval Order”); see also Securities Exchange Act Release No. 37538 (August 8, 1996); Administrative Proceeding File No. 3-9056 (“SEC Order”). In the OATS Approval Order, the Commission concluded that OATS satisfied the conditions of the SEC Order and was consistent with the Exchange Act. See 63 FR at 12566-67. As noted, the Plan is designed to create, implement and maintain a CAT that would capture customer and order event information for orders in NMS Securities and OTC Equity Securities, across all markets, from the time of order inception through routing, cancellation, modification, or execution in a single consolidated data source. FINRA has already adopted rules to enforce compliance by its Industry Members, as applicable, with the provisions of the Plan. See Rule 6800 Series.

Once the CAT can replace OATS, FINRA believes it will be appropriate to delete the OATS Rules that were implemented to comply with the SEC Order. FINRA will not transition from OATS to CAT until its surveillance program is fully prepared for such transition. Accordingly, FINRA believes that it would continue to be in compliance with the requirements of the SEC Order once the OATS Rules are deleted.

<sup>18</sup> See CAT NMS Plan, Appendix C, Section C.9.

data as submitted by a CAT Reporter before any required corrections are performed). The Participants noted in the Plan that their expectation was that “error rates after reprocessing of error corrections will be de minimis.”<sup>19</sup> The Participants based this Error Rate on their consideration of “current and historical OATS Error Rates, the magnitude of new reporting requirements on the CAT Reporters and the fact that many CAT Reporters may have never been obligated to report data to an audit trail.”<sup>20</sup>

FINRA agrees with the Participants’ conclusion that a 5% pre-correction threshold “strikes the balance of adapting to a new reporting regime, while ensuring that the data provided to regulators will be capable of being used to conduct surveillance and market reconstruction, as well as having a sufficient level of accuracy to facilitate the retirement of existing regulatory reports and systems where possible.”<sup>21</sup> However, FINRA does not believe that a 5% error rate alone would ensure a sufficient level of data accuracy and reliability for purposes of surveillance and investigations, and as noted above, the expectation is that error rates after reprocessing of error corrections also must be de minimis. Accordingly, FINRA believes that, when assessing the accuracy and reliability of the data for the purposes of retiring OATS, the error thresholds should be measured in more granular ways and should also include maximum error rates of post-correction data, which represents the data most likely to be used by FINRA to conduct surveillance. Although FINRA is proposing to measure the appropriate error rates in the aggregate, rather than firm-by-firm, FINRA believes that the error rates should be measured

---

<sup>19</sup> See CAT NMS Plan, Appendix C, Section A.3(b), at note 102.

<sup>20</sup> See CAT NMS Plan, Appendix C, Section A.3(b).

<sup>21</sup> See supra note 20.

solely for equity securities since options orders are not currently reported regularly or included in OATS.

To ensure the CAT's accuracy and reliability, FINRA is proposing that, before OATS could be retired, the CAT would generally need to achieve a sustained error rate for Industry Member reporting in each of the categories below for a period of at least 180 days of 5% or lower, measured on a pre-correction or as-submitted basis, and 2% or lower on a post-correction basis (measured at T+5).<sup>22</sup> FINRA is proposing to measure the 5% pre-correction and 2% post-correction thresholds by averaging the error rate across the period, not require a 5% pre-correction and 2% post-correction maximum each day for 180 consecutive days. FINRA believes that measuring each of the thresholds over the course of 180 days will ensure that the CAT consistently meets minimum accuracy and reliability thresholds for Industry Member reporting while also ensuring that single-day measurements do not unduly affect the overall measurements.

Based on prior experience with OATS, FINRA believes that a 2% post-correction error rate is the appropriate maximum standard for purposes of retiring OATS. Currently, OATS non-compliance rates are lower than 2% – generally at or slightly below 1%. However, compliance rates have not always been at this level, particularly with the implementation of new OATS reporting requirements.<sup>23</sup> These higher non-compliance rates following major releases have been

---

<sup>22</sup> The Plan requires that the Plan Processor must ensure that regulators have access to corrected and linked order and Customer data by 8:00 a.m. Eastern Time on T+5. See CAT NMS Plan, Appendix C, Section A.2(a).

<sup>23</sup> As discussed in the CAT NMS Plan, the Participants considered industry experience with OATS for purposes of determining the applicable Error Rate for the CAT, noting that there have been three major industry impacting releases: (1) OATS Phase III, which required manual orders to be reported to OATS; (2) OATS for OTC Securities which required OTC equity securities to be reported to OATS; and (3) OATS for NMS which required all NMS stocks to be reported to OATS. Each of these releases was



temporary and did not result in a degradation of FINRA's surveillance capabilities. With experience over time, the OATS compliance rates have dramatically improved and, as noted above, the post-correction error rate is generally at or below 1% today. FINRA anticipates that this will be the case with respect to CAT reporting, which is anticipated to be more complex and new to some firms and therefore more likely to contain errors when initially reported. Thus, FINRA believes that a 2% post-correction error rate strikes a reasonable balance between the potential costs of retaining OATS and requiring duplicative reporting by firms for a longer period in order to achieve a lower error rate and any potential impact on FINRA's surveillance capabilities, which FINRA anticipates would be temporary. Importantly and as further discussed below, while error rates are a key standardized measure in determining whether OATS retirement is appropriate, FINRA's use of the data in the CAT also must confirm that there are no material issues that have not been corrected, the CAT includes all data necessary to allow FINRA to continue to meet its surveillance obligations and the Plan Processor is sufficiently meeting its obligations under the CAT NMS Plan relating to the reporting and linkage of Phase

---

accompanied by significant updates to the required formats which required OATS reporters to update and test their reporting systems and infrastructure. The CAT NMS Plan also cites the combined average error rates for the time periods immediately following release across five significant categories for these three releases: The average rejection percentage rate, representing order events that did not pass systemic validations, was 2.42%. The average late percentage rate, representing order events not submitted in a timely manner, was 0.36%. The average order/trade matching error rate, representing OATS Execution Reports unsuccessfully matched to a FINRA Facility trade report was 0.86%. The average Exchange/Route matching error rate, representing OATS Route Reports unsuccessfully matched to an exchange order was 3.12%. Finally, the average Interfirm Route matching error rate, representing OATS Route Reports unsuccessfully matched to a report representing the receipt of the route by another reporting entity was 2.44%. The Plan further notes that the error rates for the 1999 initial OATS implementation were significantly higher (e.g., the initial rejection rates for OATS were 23% and the late reporting rate was 2.79%). See CAT NMS Plan, Appendix C, Section A.3(b).

2a Industry Member Data. As such, even if maximum error rates are met, FINRA must evaluate and confirm that overall, there are no material issues and the data is accurate and reliable.<sup>24</sup>

FINRA is proposing to use error rates in each of the following categories, measured solely for equities, to assess whether the threshold pre- and post-correction error rates are being met:

- Rejection Rates and Data Validations. FINRA has reviewed the data validations for the CAT, which are set forth in the Industry Member Technical Specifications published by the Plan Processor,<sup>25</sup> and confirmed that they are substantially similar to OATS. While not required to be designed the same as OATS, data validations must be functionally equivalent to OATS in accordance with the CAT NMS Plan (i.e., the same types of basic data validations must be performed by the Plan Processor to comply with the CAT NMS Plan requirements). Appendix D of the Plan, for example, requires that certain file

---

<sup>24</sup> FINRA notes that while error rates after reprocessing of error corrections are ultimately expected to be de minimis for the CAT (see CAT NMS Plan, Appendix C, note 102), FINRA does not believe that post-correction errors need to be de minimis before OATS can be retired and is not suggesting, with this proposal, that 2% would meet the ultimate objective of de minimis error rates for CAT.

<sup>25</sup> See, e.g., Industry Member Technical Specifications (2a/2b) version 2.2.1 r6, dated June 22, 2020, available at [www.catnmsplan.com/sites/default/files/2020-06/CAT\\_Reporting\\_Technical\\_Specifications\\_for\\_Industry%20Members\\_v2.2.1r6\\_CLEAN.pdf](http://www.catnmsplan.com/sites/default/files/2020-06/CAT_Reporting_Technical_Specifications_for_Industry%20Members_v2.2.1r6_CLEAN.pdf).

validations<sup>26</sup> and syntax and context checks be performed on all submitted records.<sup>27</sup> If a record does not pass these basic data validations, it must be rejected and returned to the CAT Reporter to be corrected and resubmitted.<sup>28</sup> The Plan also requires the Plan Processor to provide daily statistics on rejection rates after the data has been processed, including the number of files rejected and accepted, the number of order events accepted and rejected, and the number of each type of report rejected.<sup>29</sup> FINRA is proposing that, over the 180-day period, aggregate rejection rates (measured solely for equities) must be no more than 5% pre-correction or 2% post-correction across all CAT Reporters.

- Intra-Firm Linkages. The Plan requires that “the Plan Processor must be able to link all related order events from all CAT Reporters involved in the lifecycle of an order.”<sup>30</sup> At a minimum, this requirement includes the creation of an order lifecycle between “[a]ll order events handled within an individual CAT Reporter, including orders routed to internal desks or departments with different functions (e.g., an internal ATS).”<sup>31</sup> FINRA

---

<sup>26</sup> See CAT NMS Plan, Appendix D, Section 7.2. The Plan requires the Plan Processor to confirm that file transmission and receipt are in the correct formats, including validation of header and trailers on the submitted report, confirmation of a valid SRO-Assigned Market Participant Identifier, and verification of the number of records in the file.

<sup>27</sup> See supra note 26. The Plan notes that syntax and context checks would include format checks (i.e., that data is entered in the specified format); data type checks (i.e., that the data type of each attribute conforms to the specifications); consistency checks (i.e., that all attributes for a record of a specified type are consistent); range/logic checks (i.e., that each attribute for every record has a value within specified limits and the values provided are associated with the event type they represent); data validity checks (i.e., that each attribute for every record has an acceptable value); completeness checks (i.e., that each mandatory attribute for every record is not null); and timeliness checks (i.e., that the records were submitted within the submission timelines).

<sup>28</sup> See supra note 26.

<sup>29</sup> See supra note 26.

<sup>30</sup> See CAT NMS Plan, Appendix D, Section 3.

<sup>31</sup> See supra note 30.

is proposing that aggregate intra-firm linkage rates across all Industry Member Reporters must be at least 95% pre-correction and 98% post-correction.

- Inter-Firm Linkages. The order linkage requirements in the Plan also require that the Plan Processor be able to create the lifecycle between orders routed between broker-dealers.<sup>32</sup> FINRA is proposing that at least a 95% pre-correction and 98% post-correction aggregate match rate be achieved for orders routed between two Industry Member Reporters.<sup>33</sup>
- Order Linkage Rates. In addition to creating linkages within and between broker-dealers, the Plan also includes requirements that the Plan Processor be able to create lifecycles to link various pieces of related orders.<sup>34</sup> For example, the Plan requires linkages of order information to create an order lifecycle from origination or receipt to cancellation or execution. In addition, the Plan requires linkages between customer orders and “representative” orders created in firm accounts for the purpose of facilitating a customer order, riskless principal orders, and orders worked through average price accounts.<sup>35</sup> Pursuant to the phased approach for Industry Member reporting, certain of these order linkages will not be required in the initial phase of reporting (or “phase 2a”), which commenced on June 22, 2020.<sup>36</sup> For example, linkages for representative order scenarios

---

<sup>32</sup> See supra note 30.

<sup>33</sup> This assumes linkage statistics will include both unlinked route reports and new orders where no related route report could be found.

<sup>34</sup> See CAT NMS Plan, Appendix D, Section 3.

<sup>35</sup> See supra note 34.

<sup>36</sup> See CAT Reporting Timelines at [www.catnmsplan.com/timelines/](http://www.catnmsplan.com/timelines/). See also Securities Exchange Act Release No. 88702 (April 20, 2020), 85 FR 23075 (April 24, 2020) (Order Granting Conditional Exemptive Relief from Sections 6.4, 6.7(a)(v) and 6.7(a)(vi) of the

involving agency average price trades, net trades and aggregated orders will not be required until the third phase of reporting (or “phase 2c”) is implemented in April 2021; such linkages are not required in OATS today. FINRA is proposing that there be at least a 95% pre-correction and 98% post-correction rate for order linkages that are required in phase 2a.

FINRA notes that in phase 2a, linkage is required between the representative street side order and the order being represented when the representative order was originated specifically to represent a single order (received either from a customer or another broker-dealer) and there is: 1) an existing direct electronic link in the firm’s system between the order being represented and the representative order, and 2) any resulting executions are immediately and automatically applied to the represented order in the firm’s system.<sup>37</sup> While such linkages are not required in OATS today, FINRA believes that it is appropriate to evaluate them for purposes of retiring OATS. These linkages represent a significant enhancement to the data currently available in OATS and will enhance the quality of the equity audit trail. FINRA further notes that linkages for more complex representative order scenarios, such as those involving agency average price trades, net trades and aggregated orders, will not be required until phase 2c. Accordingly, FINRA does not anticipate that the error rates for the phase 2a representative order linkages in CAT would be significantly higher than the order linkages available in OATS

---

CAT NMS Plan) (“Phased Industry Member Reporting Exemptive Order”) and FINRA Rule 6895.

<sup>37</sup> See Industry Member Technical Specifications (2a/2b) version 2.2.1 r6, dated June 22, 2020, available at [www.catnmsplan.com/sites/default/files/2020-06/CAT\\_Reporting\\_Technical\\_Specifications\\_for\\_Industry%20Members\\_v2.2.1r6\\_CLEAN.pdf](http://www.catnmsplan.com/sites/default/files/2020-06/CAT_Reporting_Technical_Specifications_for_Industry%20Members_v2.2.1r6_CLEAN.pdf).

today. Nonetheless, in evaluating whether the standards for OATS retirement have been met, FINRA will take into consideration if the error rates for the phase 2a representative order linkages have a significant negative impact on the overall error rates for order linkages.

- Exchange and TRF/ORF Match Rates. The Plan requires that an order lifecycle be created to link “[o]rders routed from broker-dealers to exchanges” and “[e]xecuted orders and trade reports.”<sup>38</sup> FINRA is proposing at least a 95% pre-correction and 98% post-correction aggregate match rate to each equity exchange for orders routed from Industry Members to an exchange and, for over-the-counter executions, the same match rate for orders linked to trade reports.

FINRA intends to commence its review of CAT data and error rates based on phase 2a data and linkages, which would replicate the data in OATS today, and will not wait for implementation of phase 2c reporting (and the attendant linkages) to do so. As discussed in the Phased Industry Member Reporting Exemptive Order,<sup>39</sup> Phase 2a Industry Member Data includes all events and scenarios covered by OATS. FINRA Rule 7440 describes the OATS requirements for recording information, which includes information related to the receipt or origination of orders, order transmittal, and order modifications, cancellations and executions. Large Industry Members and Small Industry Members that currently are reporting to OATS (“Small Industry OATS Reporters”) are required to submit data to the CAT for these same events and scenarios during phase 2a. Accordingly, Phase 2a Industry Member Data is the most relevant for OATS retirement purposes.

---

<sup>38</sup> See CAT NMS Plan, Appendix D, Section 3.

<sup>39</sup> See supra note 36.

FINRA anticipates retiring OATS based solely on phase 2a reporting, assuming the threshold pre- and post-correction error rates are achieved and FINRA's use of the data confirms that the data is accurate and reliable, as discussed below. This is because, as noted above, phase 2a data and linkages will replicate what is in OATS today; the data and linkages that are not required to be reported until phase 2c are not in OATS today. OATS will not be retired prior to commencement of phase 2c reporting by Large Industry Members in April 2021, and there may be an initial increase in error rates immediately following implementation of the new phase 2c reporting requirements. FINRA does not believe that such increase would impact FINRA's ability to assess the accuracy and reliability of phase 2a data for purposes of determining OATS retirement. In addition, FINRA believes that Industry Members would gain experience with the new 2c reporting requirements over time, such that the expected increase in the error rate would dissipate. Such short-lived increase is not expected to have an impact on FINRA's ability to meet its surveillance obligations.

Even if these error rate thresholds are met, FINRA must evaluate and confirm through incorporation of CAT Data into its automated surveillance program that the data is accurate and reliable.<sup>40</sup> Thus, in addition to the maximum error rates and matching thresholds proposed above, FINRA's use of CAT Data must confirm that (i) there are no material issues that have not been corrected (e.g., delays in the processing of data, issues with query functions, etc.), (ii) the CAT includes all data necessary to allow FINRA to continue to meet its surveillance obligations and (iii) the Plan Processor is sufficiently meeting its obligations under the CAT NMS Plan relating to the reporting and linkage of Phase 2a Industry Member Data. FINRA notes that any

---

<sup>40</sup> For example, FINRA will need to transition all or substantially all of its automated surveillance patterns to CAT Data in order to evaluate the accuracy and reliability of the data.

errors in the CAT Data may manifest themselves only after surveillance patterns and other queries have been run. Thus, while the error rate thresholds may be met over a 180-day period, additional time may be required to reliably establish that usage of the CAT has not revealed material issues that have not been corrected and allow contextual analysis of the data to take place to uncover errors in reporting or processing that may not be apparent from more standardized data validation processes.<sup>41</sup>

Based on the proposed accuracy and reliability standards described above, FINRA anticipates that the time period for implementation for the deletion of the OATS Rules could be significant. Thus, in order to help alert members of the status of the OATS Rules, if the Commission approves the proposed rule change, FINRA is proposing to add introductory language to Rule 4554 and the Rule 7400 Series clarifying that the SEC has approved a proposed rule change (SR-FINRA-2020-024) to remove Rule 4554 and the Rule 7400 Series from the FINRA rulebook; however, by its terms, SR-FINRA-2020-024 will not be implemented until FINRA has determined that the CAT has achieved a level of accuracy and reliability sufficient to replace OATS. Once FINRA has determined that such standards have been met, FINRA will file for immediate effectiveness a rule filing setting forth the basis for its determination and will publish a Regulatory Notice announcing the implementation date of SR-FINRA-2020-024. FINRA is proposing that this language be added to Rule 4554 and the Rule 7400 Series upon approval of the proposed rule change by the SEC.

---

<sup>41</sup> FINRA notes that the proposed criteria and anticipated timing of OATS retirement outlined in this filing are premised on and assume there are no material changes to the current CAT implementation plan, including availability and FINRA's access to CAT Data. Pursuant to amendments to the CAT NMS Plan adopted by the SEC, OATS must be retired by December 31, 2021 for the Plan Participants to meet the Period 3 Financial Accountability Milestone (Full Availability and Regulatory Utilization of Transactional Database Functionality). See CAT NMS Plan, Sections 1.1 and 11.6.



(c) Small Industry Member Data Availability

The second issue the Plan requires the proposed rule change to address is “whether the availability of certain data from Small Industry Members two years after the Effective Date would facilitate a more expeditious retirement of duplicative systems.”<sup>42</sup>

As discussed in the original proposal, FINRA believes that there is no effective way to retire OATS until all current OATS reporters are reporting to the CAT. Pursuant to the phased reporting approach, Small Industry OATS Reporters and Large Industry Members were required to begin reporting to the CAT on the same date, June 22, 2020.<sup>43</sup> Thus, at this time, all current OATS reporters are required to report to the CAT.<sup>44</sup> Small Industry Members that are not currently required to record and report information to OATS are required to begin reporting to the CAT in December 2021.<sup>45</sup>

FINRA believes that the requirement that all current OATS reporters begin reporting to the CAT on June 22, 2020 will expedite the retirement of OATS, providing a significant cost savings for the industry.

(d) Individual Industry Member Exemptions

The final issue the Plan requires the proposed rule change to address is “whether individual Industry Members can be exempted from reporting to duplicative systems once their CAT reporting meets specified accuracy and reliability standards, including, but not limited to,

---

<sup>42</sup> See CAT NMS Plan, Appendix C, Section C.9.

<sup>43</sup> See supra note 36.

<sup>44</sup> The 180-day timeframes discussed above with respect to usage of the data and calculation of error rates will apply to data reported to the CAT by Small Industry OATS Reporters.

<sup>45</sup> See supra note 36.

ways in which establishing cross-system regulatory functionality or integrating data from existing systems and the CAT would facilitate such Individual Industry Member exemptions.”<sup>46</sup>

FINRA believes that a single cut-over from OATS to CAT is highly preferable to a firm-by-firm approach and is not proposing to exempt members from the OATS requirements on a firm-by-firm basis. The primary benefit to a firm-by-firm exemptive approach would be to reduce the amount of time an individual firm is required to report to a legacy system (e.g., OATS) if it is also accurately and reliably reporting to the CAT. FINRA believes that the overall accuracy and reliability thresholds for the CAT described above would need to be met under any conditions before firms could stop reporting to OATS. In addition, a firm-by-firm approach would require that OATS and CAT data be combined and integrated in order for FINRA to conduct surveillance in accordance with SEC rules and SRO obligations. This process would be technologically costly and complex and could potentially compromise the quality of the data and FINRA’s surveillance. Moreover, as discussed above, Small Industry OATS Reporters are required to report to the CAT on the same timeframe as all other OATS Reporters (i.e., Large Industry Members). Thus, there is no need to exempt members from OATS requirements on a firm-by-firm basis.

If the Commission approves the proposed rule change, the rule text will be effective upon approval; however, the amendments will not be implemented until FINRA has determined the accuracy and reliability standards set forth in the proposed rule change have been met. Once FINRA has determined that such standards have been met, FINRA will file for immediate effectiveness a separate rule filing setting forth the basis for its determination and will publish a Regulatory Notice announcing the implementation date of the amendments proposed herein.

---

<sup>46</sup> See CAT NMS Plan, Appendix C, Section C.9.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>47</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and Section 15A(b)(9) of the Act,<sup>48</sup> which requires that FINRA rules not impose any burden on competition that is not necessary or appropriate.

FINRA believes that the proposed rule change fulfills FINRA's obligation under the CAT NMS Plan to submit a proposed rule change to eliminate or modify duplicative rules. FINRA believes that the approach set forth in the proposed rule change strikes the appropriate balance between ensuring that FINRA is able to continue to fulfill its statutory obligation to protect investors and the public interest by ensuring its surveillance of market activity remains accurate and effective while also establishing a reasonable timeframe for elimination the OATS Rules, which will be rendered duplicative after implementation of the CAT.

### B. Self-Regulatory Organization's Statement on Burden on Competition

#### Economic Impact Assessment

FINRA has undertaken an economic impact assessment to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs and benefits, and the alternatives considered in assessing how to best meet regulatory objectives. FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

---

<sup>47</sup> 15 U.S.C. 78o-3(b)(6).

<sup>48</sup> 15 U.S.C. 78o-3(b)(9).

### Regulatory Need

As mentioned above, once members are effectively reporting to the CAT and the CAT's accuracy and reliability meet certain standards, OATS reporting will be a duplicate effort. Accordingly, FINRA is proposing to add introductory language to Rule 7400 that facilitates the deletion of the Rule 7400 Series, upon announcement by FINRA that CAT has achieved the accuracy and reliability targets.

### Economic Baseline

Currently all FINRA members that do business in equity securities are required to report equity audit trail information to OATS. As noted above, Small Industry OATS Reporters and Large Industry Members were required to begin reporting to CAT on the same date, June 22, 2020, as part of the broader plan to implement the CAT and retire other systems. The proposed rule change lays out a plan by which FINRA will retire OATS to eventually eliminate the need for duplicative reporting and records maintenance.

Costs and benefits associated with establishing the CAT, including the economic impacts associated with retiring existing systems, have been established as a part of the Plan approved by the SEC. The proposed framework in Appendix C, Section C.9. serves as the baseline to evaluate the economic impacts of the proposed rule change. Accordingly, the next section addresses the potential impacts stemming from:

- (1) revising the reporting timeline to require that Small Industry Members that currently report to OATS begin reporting to the CAT on the same date as Large Industry Members (June 22, 2020);

- (2) implementing a single cut-over from OATS to CAT for all firms provided that average error rate thresholds over a 180-day period are met and FINRA has determined that its usage of the CAT Data has not revealed material issues; and
- (3) imposing a 2% post-correction error rate, in addition to the 5% initial Error Rate as defined in the Plan, as a condition for retiring of OATS.

### Economic Impacts

In creating the proposal to retire OATS, FINRA is seeking to carefully balance the additional costs incurred by member firms associated with continuing to maintain duplicate systems and records created by the CAT NMS Plan and existing rules with the risks to effective and efficient surveillance that could arise from eliminating access to existing data systems before a high-quality alternative has been tested and verified. The costs of maintaining duplicate systems and records include, among other things, system maintenance, quality control oversight and staff to maintain the systems and records. Because the CAT NMS Plan created the need to have duplicate systems and required a plan for the retirement of duplicate systems and processes, the Economic Impact Assessment will focus on the proposed choices made by FINRA in implementing the retirement plan.

The proposed rule change will impact all OATS-reporting firms. As of June 30, 2019, 616 (of 936) large FINRA member broker-dealers and 221 (of 476) small FINRA member broker-dealers report to OATS. Of the 221 Small Industry Members that report to OATS, all but nine of them currently report through other firms or service providers.<sup>49</sup> Of the nine that self-

---

<sup>49</sup> All of the clearing firms that report to OATS on behalf of Small Industry Members were required to begin reporting to CAT on June 22, 2020. In addition, the service providers that report to OATS on behalf of Small Industry Members have a mix of small and large clients for whom they provide this service and, therefore, began CAT reporting on behalf of their clients on June 22, 2020.

report, eight of them report very few orders to OATS.<sup>50</sup> The approximately 575 FINRA member broker-dealers that are currently exempt or excluded from OATS reporting are not impacted by this proposed rule change because they currently incur no costs in maintaining directly or indirectly systems for OATS compliance. Accordingly, the analysis here focuses on the impact of the proposed plan for retiring OATS on OATS-reporting firms only.

First, FINRA's proposal recommends a requirement that there be a single cut-over from OATS to CAT rather than a firm-by-firm cut-over. The primary beneficiary of this proposal will be the investing public. This approach eliminates the need to merge OATS and CAT data in order to execute surveillance in accordance with SEC rules and SRO obligations. The integration process would be technologically costly and difficult and could introduce errors into the data being surveilled that did not exist prior to integration. Conducting market surveillance from a single audit trail system increases the efficiency and effectiveness of the process and improves the integrity of the markets. In addition, there are direct benefits of this approach to firms. Specifically, other than during the time period during which the accuracy and reliability of CAT data is validated, a single cut-over approach would eliminate the need for firms that report on other firms' behalf to create a technological solution for receiving and reporting on data structured for both OATS and CAT simultaneously. Such a practice would increase costs to ensure compliance with the proper reporting mechanism. These costs would likely be

---

<sup>50</sup> As noted above, FINRA has identified approximately 221 member firms that currently report to OATS and meet the definition of "Small Industry Member;" however, only nine of these firms submit information to OATS on their own behalf, and five of the nine firms report very few orders to OATS. For example, in one recent month, five of the nine firms submitted fewer than 25 reports during the month, with four firms submitting fewer than 10.

incorporated into the fees for the service charged to introducing firms and could eventually be borne by customers through higher fees based on the price elasticity for brokerage services.

The potential costs associated with the single cut-over approach will be borne by firms that could meet the maximum error thresholds for reporting to CAT earlier than the single cut-over approach would allow. These firms would bear the technology and compliance costs associated with dual reporting for a longer period than they might otherwise.

Another potential cost of the single cut-over method is that there will likely be firms reporting to CAT that do not meet the maximum error rate thresholds, leading to lower quality data available for surveillance. If firms were individually permitted to end OATS reporting only when meeting a maximum error rate, every firm's reporting would meet the minimum criterion. Requiring an aggregate error rate may permit individual firms to end OATS reporting even while their CAT reporting does not meet the specified error rate as long as the error rate is low enough for the industry. Thus, surveillance of market activity for those firms may not be as efficient or effective due to the higher error rates. Taken further, it is possible that a single cut-over may reduce the incentives for any one firm to put significant effort and costs into meeting or beating the threshold error rates because the benefits are shared among all firms while greater cost is borne by the firms whose compliance rates satisfy the minimum error rate thresholds. This disincentive is likely to be small for firms with significant reporting obligations, who would seek to end duplicative reporting as quickly as possible and who represent the vast majority of OATS reports, but may, at the margin, extend the time necessary to meet the error reporting threshold. However, significant error rates could constitute a rule violation and subject firms to possible

disciplinary action.<sup>51</sup> Thus, firms that delay reducing error rates to threshold levels would over time incur higher costs through enforcement actions and be incentivized to improve their compliance rates.

With respect to the revised timeline requiring that all firms that report to OATS begin CAT reporting on June 22, 2020, this requirement means that 221 Small Industry Members were required to begin reporting to the CAT on the same timeframe as Large Industry Members. The primary benefit of this approach is that it allows the OATS system to be retired up to a year earlier, saving firms the costs of maintaining duplicate reporting systems. Of the estimated 221 firms that would be impacted by this proposal, 212 report to OATS through clearing firms or other third party providers, all of whom were required to begin CAT reporting on June 22, 2020 either by the requirement in the Plan or on behalf of clients who are required to in the Plan. Thus, there should be limited additional technical requirements or costs to facilitate reporting for these firms. In fact, requiring Small Industry OATS Reporters to report to the CAT on the same timeframe as Large Industry Members will likely allow the introducing and clearing firms to avoid the costs associated with maintaining two systems for reporting during the additional transition year. The other nine small firms will be required to incur costs associated with the changeover to CAT a year earlier. The magnitude of these costs is dependent on several factors, including the volume of trades expected to be reported to CAT as well as the technological differences between the OATS system specifications and CAT system specifications.

Third, FINRA proposes that the official retirement of OATS occurs only once CAT has met minimum accuracy and reliability standards defined as a maximum error rate of 5% on a

---

<sup>51</sup> See CAT NMS Plan, Appendix C, Section 3(b) (discussing firm-specific compliance thresholds).



pre-correction basis and 2% on a post-correction basis for all CAT submissions averaged over a 180-day period in applicable categories, and FINRA has determined that its usage of the CAT Data has not revealed material issues that have not been corrected, confirmed that the CAT includes all data necessary to allow FINRA to continue to meet its surveillance obligations and confirmed that the Plan Processor is sufficiently meeting its obligations under the CAT NMS Plan relating to the reporting and linkage of Phase 2a Industry Member Data. FINRA believes that a minimum of 180 days is required to provide sufficient time to ensure that future error rates below the maximum thresholds are able to be maintained and that the CAT data can otherwise be relied upon for conducting effective market surveillance. The trade-offs of lengthening or shortening the phase-in period and raising or lowering error rate thresholds are increased costs to member firms for maintaining duplicate reporting systems and records versus reliable surveillance and effective investigations of market activity, whose benefits eventually accrues to investors. Note that the current OATS error rates are significantly lower than 2%; however, OATS reporting errors have decreased over time with additional experience by firms, and CAT reporting is anticipated to be more complex and new to some firms and therefore more likely to contain errors when initially reported.

#### Alternatives Considered

In considering how to best meet its regulatory objectives, FINRA considered several alternatives in the design of the proposed rule changes. Among these alternatives, FINRA assessed whether Small Industry Members should be subject to a different effective date for CAT reporting. It was determined that Small Industry OATS Reporters should begin reporting to CAT on the same date that Large Industry Members begin reporting, to enable linkages across

order lifecycle events, enhancing surveillance and potentially permitting OATS to be retired more quickly.

FINRA also considered a firm-by-firm approach, for exempting members from the OATS reporting requirements, as an alternative to single cut-over from OATS to CAT. FINRA determined that this approach represented a higher threshold for the industry to meet, likely increasing costs and the period where both CAT and OATS would be required simultaneously. Further, such an approach would also potentially reduce the efficacy of the audit trail, creating no substantial benefit to investor protection. Therefore, FINRA is proposing to implement a single cut-over approach for retirement of OATS.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

As discussed above, FINRA provided similar views and mechanisms for eliminating the OATS Rules in the original proposal.<sup>52</sup> Four comment letters were submitted in response,<sup>53</sup> and FINRA subsequently filed an amendment to the original proposal, which summarized and responded to the comments received.<sup>54</sup> Three of the four commenters filed additional comment

---

<sup>52</sup> See supra note 12.

<sup>53</sup> See Letters from Marc R. Bryant, Senior Vice President and Deputy General Counsel, Fidelity Investments, to Robert W. Errett, Deputy Secretary, SEC, dated June 22, 2017 ("Fidelity"); William H. Hebert, Managing Director, Financial Information Forum, to Robert W. Errett, Deputy Secretary, SEC, dated June 22, 2017 ("FIF"); Manisha Kimmel, Chief Regulatory Officer, Wealth Management, Thomson Reuters, to Brent J. Fields, Secretary, SEC, dated June 22, 2017 ("Thomson Reuters"); and Ellen Greene, Managing Director & Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Brent J. Fields, Secretary, SEC, dated June 23, 2017 ("SIFMA").

<sup>54</sup> See Securities Exchange Act Release No. 81499 (August 30, 2017), 82 FR 42168 (September 6, 2017); see also Letter from Brant K. Brown, Associate General Counsel, FINRA, to Brent J. Fields, Secretary, SEC, dated August 28, 2017.

letters in response to the amendment,<sup>55</sup> and FINRA filed a response to comments.<sup>56</sup> In addition, prior to the original proposal, FIF and SIFMA submitted letters to the Participants regarding the retirement of systems related to the CAT.<sup>57</sup> The comment letters, as well as FINRA's partial amendment and subsequent response to comments (which were filed with the Commission as comment letters), are available on the Commission's website.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

### IV. Solicitation of Comments

---

<sup>55</sup> See Letters from Manisha Kimmel, Chief Regulatory Officer, Wealth Management, Thomson Reuters, to Brent J. Fields, Secretary, SEC, dated September 27, 2017; William H. Hebert, Managing Director, FIF, to Heather Seidel, Acting Director, Division of Trading and Markets, SEC, dated September 29, 2017; and Ellen Greene, Managing Director & Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA, to Brent J. Fields, Secretary, SEC, dated September 29, 2017.

<sup>56</sup> See Letter from Brant K. Brown, Associate General Counsel, FINRA, to Brent J. Fields, Secretary, SEC, dated October 11, 2017.

<sup>57</sup> See Letter from Kenneth E. Bentsen, Jr., SIFMA, to Participants re: Selection of Thesys as CAT Processor, dated April 4, 2017, at 2; Letter from William H. Hebert, FIF, to Participants re: Milestone for Participants' rule change filings to eliminate/modify duplicative rules, dated April 12, 2017.

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2020-024 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2020-024. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from

comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2020-024 and should be submitted on or before **[INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER]**.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>58</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. 2020-19192 Filed: 8/31/2020 8:45 am; Publication Date: 9/1/2020]

---

<sup>58</sup> 17 CFR 200.30-3(a)(12).